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Supreme Court of the United States

October Term, 1961

No. ...738

MELVILLE HARRIS, as Trustee in Bankruptcy of LEONARD MASSELLO and WILLIAM MASSELLO,

Petitioner,

v.

STANDARD ACCIDENT AND INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Supreme Court of the United States

OCTOBER TERM, 1961

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Petitioner,

v.

STANDARD ACCIDENT AND INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered December 6, 1961, which, by a majority, reversed a judgment of the United States District Court for the Southern District of New York, entered after trial before the Court without a jury, in favor of Petitioner against Respondent for the sum of $89,000 and dismissed the complaint. Petitioner sued for damages to the bankrupts resulting from Respondent's bad faith refusal to settle a personal injury action within the limits of a liability policy issued by Respondent to the bankrupts. The $89,000 represented the unpaid excess of the judgment rendered against the bankrupts over the amount of the insurance coverage.

Opinions Below

The opinion of the District Court (R. 302a), printed in the Appendix hereto, *infra*, page 21, is reported in 191 F. Supp. 538. The opinions of the Circuit Court of Appeals (R. 317a) printed in the Appendix hereto, *infra*, pages 36, 54, have not yet been reported.

Jurisdiction

The judgment of the Court of Appeals was made and entered December 6, 1961. The jurisdiction of this Court is invoked under 28 U. S. C. §1254(1). This petition is filed within the time prescribed by 28 U. S. C. §2101(c).

Questions Presented

1. Is a federal bankruptcy trustee barred from recovery upon the bankrupts' right of action against their insurer for the latter's refusal in bad faith and in contravention of its obligations under the policy to settle within the limits of the policy a personal injury action against the bankrupts, because the bankrupts paid no part of the excess judgment rendered against them and were insolvent before the entry of the judgment?

2. Can the insurer avoid the obligation of good faith to its insureds and escape the consequences of its bad faith merely because its insureds were insolvent and unable to pay the excess judgment?

3. Does a federal bankruptcy trustee have no right of action against the bankrupts' insurer when he does not show that the bankrupts personally suffered any loss or harm other than going into bankruptcy?

4. If, subsequent to the institution of the action by the bankruptcy trustee against the insurer, the bankrupts were discharged by order of the Referee in Bankruptcy, but the bankruptcy proceedings remained open, is the trustee thereby barred from recovery in said action?

5. Is a federal bankruptcy trustee's right to recover extinguished by the fact that the largest creditor of the bankrupts' estate (the party who will primarily benefit from a recovery by the trustee) is the same party who obtained the excess judgment against the bankrupts?

Statute Involved

The statute involved is Section 70(a) of the Bankruptcy Act, 11 U. S. C. 110(a). Its appropriate text is printed in the Appendix hereto, *infra*, page 57.

Statement of the Case *

1. The Bankruptcy

On June 24, 1957 the bankrupts filed voluntary petitions in bankruptcy in the United States District Court for the Southern District of New York and were adjudicated bankrupts. On September 13, 1957 Petitioner was appointed Trustee in Bankruptcy and he thereafter qualified and acted as such. Pursuant to Section 47(a) of the Bankruptcy Act, 11 U. S. C. 75(a), which prescribes his duties, and Section 70(a)(5), (6) of the Bankruptcy Act, 11 U. S. C. 110(a)(5), (6), which vested the title to the bankrupts' right of action in him, Petitioner-Trustee, on October 15, 1958, commenced this action against Respondent-Insurer.

* The following statements, except where otherwise indicated, are from the findings of the courts below as set forth in their opinions.

2. The Trustee's Action

The action arose from an automobile accident which occurred on January 5, 1952. Mrs. Elizabeth Van Suetendael, while on a sidewalk in Yonkers, New York, was severely and permanently injured as the result of a collision of a truck and a taxi. The taxi was caused to run on to the sidewalk and pin her against a brick fence pillar. The truck was owned by Leonard Massello and Pasquale Manzella and was operated by William Massello. They were insured by Respondent to the limit of $10,000 for one person injured. The taxi was owned by Henry Golden and operated by Henry Lichtenstein. They were insured by the Travelers Insurance Company to the limit of $5,000 for one person injured.

Mrs. Van Suetendael brought an action in the Supreme Court of the State of New York, Westchester County, against the owners and drivers of both vehicles.

In March, 1957 the case came on for trial before Hon. George Fanelli, Justice, and a jury. During the course of the trial settlement discussions were had before the Justice. Respondent's trial counsel, who realized that because of the severe injuries the verdict would be far in excess of the policy limits, conceded in the settlement conferences that Respondent's insureds did not have a reasonable chance of success on the trial.

Mrs. Van Suetendael, through her attorney, offered to accept in settlement the amount of the combined insurance, i.e., $5,000 from The Travelers and $10,000 (or even a little less) from Respondent. The Travelers offered to pay its policy limit of $5,000. Respondent offered only to match the $5,000 offered by The Travelers and refused to pay any more. Although Respondent's counsel agreed with the opinion expressed by Justice Fanelli that both

sets of defendants would be held liable, he refused to pay in settlement any more than the $5,000 which The Travelers had offered to pay. Subsequently, he declared to Mrs. Van Sneteindael's attorney that they would have to finish the trial because the Respondent had nothing to lose.

The trial resulted in a verdict against all defendants amounting to $105,000 and judgment was entered on April 4, 1957. Respondent paid $10,000, the limit of its policy. The Travelers paid $5,000, the limit of its policy. The taxi owner personally paid $1,000 and received a release of the lien of the judgment against him. The remaining unpaid balance of the judgment was $89,000. Subsequent to the entry of the judgment the Massellos filed their petitions in bankruptcy.

3. The District Court

A. The Contentions

The Trustee contended that the contract of insurance imposed on Respondent the obligation to exercise good faith in carrying out its terms; that Respondent knew it did not have a reasonable prospect of success in the personal injury action and that a verdict would be far in excess of the policy limits, but gambled on the trial, in complete disregard of its insureds' interests, because Respondent had nothing to lose by a trial and a bare possibility of saving itself approximately $10,000; that, therefore, Respondent's refusal to settle within the policy limits constituted bad faith; and that the mere entry of the excess judgment established the damage and its measure.

Respondent contended that it exercised good faith throughout, that it determined to proceed to trial because of a *bona fide* belief that liability could be avoided,

and, also, that since the Massellos were insolvent Respondent was not exposing them to any substantial risk in proceeding to trial.

Upon the trial, the Trustee produced as witnesses, among others, the New York State Supreme Court Justice who had presided at the trial of the personal injury action and the attorneys who had appeared before him representing Mrs. Van Suetendael and The Travelers Insurance Company.

The District Court credited the testimony of the Trustee's witnesses and found that Respondent's failure to settle within the policy limits was bad faith.

B. Jurisdiction of the Court of First Instance

The jurisdiction of the District Court was alleged (R. 3a) to rest on diversity of citizenship, 28 U. S. C. §1332 and on plaintiff being a trustee in bankruptcy, 11 U. S. C. §46(b). Respondent did not dispute the Trustee's allegations of jurisdiction. The District Court seems to have assumed that there was jurisdiction and did not refer to the matter in its opinion.

The Court of Appeals held that the allegations of fact in the complaint were insufficient to support jurisdiction on the basis of diversity of citizenship, but that, on the other hand, the District Court had jurisdiction under Section 23(b) of the Bankruptcy Act, 11 U. S. C. §46(b), which gives federal courts jurisdiction of suits brought by the Trustee if the defendant consents. It held that by appearing and arguing the merits without objection to jurisdiction Respondent had consented to the District Court's jurisdiction.

C. The District Court Decision

The District Court (Irving R. Kaufman, D. J., sitting without a jury) found that the theory of the Trustee's action, i.e., that Respondent's refusal to settle was in bad faith, was a theory of liability recognized in New York (*Best Building Co. v. Employers Liab. Assur. Corp.*, 247 N. Y. 451 (1928)), as well as in most other jurisdictions. He amplified his finding by explaining that the law imposes on the insurer the obligation of good faith; "the duty to consider, in good faith, the insured's interests as well as its own when making decisions as to settlement" (R. 304a).

The Court found that the evidence established conclusively that Respondent failed to give adequate consideration to the interests of the Massellos, its insureds; that not only did the objective criteria of bad faith, i.e., the severity of the injuries and the probability of a plaintiff's verdict against the insureds, coincide, but the admissions by Respondent's trial attorney in the settlement discussions before Justice Fanelli that he knew that the chance of a verdict in favor of Respondent's insureds was minimal, clearly illustrated the bad faith approach; that there was an attitude of intransigence and failure of Respondent to understand its responsibility to the insureds; and that its attitude throughout was that it had nothing whatsoever to gain from a settlement approximating the policy limits and nothing to lose by going to trial.

Respondent's attorney and witness admitted in response to a question by the Court that everybody is hurt if he has a judgment against him, even if he is insolvent; that he is hurt in the sense that the judgment makes the insolvency worse, and his chance of getting back on his feet is made so much more difficult (R. 182a).

The Court held, accordingly, that the insured's financial condition was not a relevant consideration when the insurer was making a determination as to whether to settle, and pointed out that the risk of bankruptcy was not an insubstantial one and that it was likely to eventuate in considerable further embarrassment and impairment of credit; that it was not the function of the insurer when undertaking the defense of an action, to ascertain the financial condition of its insured and to consider that factor in making a determination to defend; but that a decision as to whether to settle or to proceed to trial should be on the basis of an objective appraisal of the possibility of success; that other extraneous considerations should be disregarded, and that a determination not to settle should be only upon a *bona fide* belief that there is a real likelihood of prevailing in the action (R. 311a, 312a).

On the question of damages the Court recognized that there was a split among the jurisdictions as to whether payment of the excess judgment by the insured was a prerequisite to recovery. He noted that the more recent cases held that the entry of judgment was sufficient in itself to warrant recovery, but that New York had not yet announced any rule on the question of damages. He decided, as a matter of federal bankruptcy law: "But I do not think it desirable to impose a requirement of payment as a prerequisite to recovery in a case such as this, when the insured is insolvent at the time of trial and is eventually forced into bankruptcy. If payment were a prerequisite in such a situation, the company could easily avoid the duty of good faith owed to the insured. For example, if the company knew, as it presumably would, of the insured's poor financial condition, it would then risk little by proceeding to trial regardless of the chances of success. Since the likelihood of payment of the excess by the insured would be slight, the chance of an ultimate re-

covery over of the excess against the insurer would be minimal. Thus, to require payment as a prerequisite would be to emasculate the important substantive policies underlying the obligation of good faith, at least in a case in which the insured's financial status renders payment impossible or unlikely" (R. 313a).

By pointing out that the recovery would inure to the benefit of the Trustee, not the bankrupts, and would be available for payment of creditor claims, the District Court necessarily held that under the Bankruptcy Act the Trustee was not barred from recovery by the facts that the bankrupts did not pay any portion of the excess judgment, but were actually insolvent at the time the excess judgment was entered and were forced into bankruptcy as a result of the judgment.

4. The Court of Appeals Decision

A. The Majority

The majority, in an opinion by Lumbard, Chief Judge, held that the Trustee had failed to prove any damages. Its decision was based on the grounds that the bankrupts were insolvent before the excess judgment was rendered, had not paid any part of it, and had been discharged from liability for it by bankruptcy.

The majority conceded that the New York Courts had not passed on the question raised by the Trustee's contentions that regardless of their financial condition the bankrupts were damaged by the mere entry of the excess judgment and that the entry thereof established not only the damage but its measure. The majority also stated that other states had split on whether the insured is damaged by an uncollectible excess judgment against him.

The majority disregarded the fact that before the entry of the excess judgment the insolvent insureds had the opportunity to improve their financial condition, pay off their creditors and become solvent, but that this opportunity was destroyed when the excess judgment was entered against them, so that they were forced into bankruptcy. The majority intimated that it agreed with the older cases which held that payment of the judgment was a prerequisite to recovery, and disagreed with the more recent cases which held that the entry of the judgment was sufficient in itself to warrant recovery of the unpaid excess amount. The majority sought to distinguish the latter cases by showing that only in one [*Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (1957)] did the insured go through bankruptcy and in that case there was no evidence that the insured was insolvent before the excess judgment was rendered; and that in the other cases there was no evidence that the insured had been discharged from liability and in only two of them was there any indication that the insured was insolvent prior to the excess judgment. [But see: *Tennessee Farmers' Mut. Ins. Co. v. Wood*, 277 F. 2d 21 (C. A. 6, 1960) indicating that recovery was allowed to an insolvent insured; *Southern Fire & Cas. Co. v. Norris*, 35 Tenn. App. 657, 250 S. W. 2d 783 (1952) allowing recovery to an insolvent insured; *Lee v. Nationwide Mut. Ins. Co.*, 286 F. 2d 295 (C. A. 4, 1961), in which the net assets of the estate amounted to $1,441.48; *Henke v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N. W. 2d 168 (1959), in which the net assets of the estate amounted to $832.45.]

In discussing the case of *Brown v. Guarantee Ins. Co., supra*, the majority indicated that if the insured's assets exceeded his liabilities exclusive of the excess judgment then the Trustee of the insured, who was forced into

bankruptcy and subsequently discharged, could recover the entire amount of the excess judgment; whereas there could be no recovery where the insured's liabilities exclusive of the excess judgment exceeded his assets. The reason given by the majority for stating that a recovery of the entire excess judgment would be permitted in the case of the solvent insured was that the only way to make him whole, i.e., to place him in a position where his net assets were as great after as before payment of the excess judgment, would be to allow him to recover the entire amount of the judgment (R. 2564). Thus, the majority indicated that if before the entry of a substantial excess judgment an insured had assets of $1,000 and liabilities of $900, there could be a recovery of the entire amount of the excess judgment, but if the insured had assets of $900 and liabilities of $1,000 there could be no recovery at all — a most startling and inequitable result.

The majority then discussed and disagreed with the theories of those cases which had allowed recovery without payment of the excess judgment on the ground that the entry of the excess judgment established the damage and its measure.

In all, the majority found four reasons why the Trustee herein could not recover. First, there must be payment by the bankrupts of the excess judgment and there was none. Second, the bankrupts must at least demonstrate some other loss or harm and none such was demonstrated, the fact of having to go into bankruptcy being of itself insufficient as the basis for an award of damages. Third, the Trustee was barred because the bankrupts had been discharged in bankruptcy, thus necessarily holding irrelevant the facts that the right of action had passed to the Trustee as of the date of the filing of the petitions in bankruptcy, that the Trustee's action was commenced

prior to the bankrupts' discharge in bankruptcy, and that the bankruptcy proceeding had been left open pending the outcome of the litigation. Fourth, the majority disagreed with the District Court's holding that the right of action properly passed to the Trustee and was being maintained for the benefit of the bankrupts' estate, but considered instead that the result would be a "windfall" to the single largest creditor, Mrs. Van Snetendael (R. 328a). The District Court had directly suggested that such a view of the powers of a Trustee in bankruptcy, as adopted by the insurer and by the majority of the Court of Appeals, would result in a windfall to a faithless insurer fortunate enough to insure an insolvent (R. 313a).

B. The Dissent.

Circuit Judge J. Joseph Smith, dissenting, took issue with the majority's view that the bankrupts had suffered no harm by the docketing of the judgment, which forced them to go into bankruptcy. He agreed with the District Court's view that there was no warrant, either in the Bankruptcy Law or in New York law, for any requirement that the bankrupts themselves must have undergone injury apart from the claim (based on the entry of the excess judgment) which passed from the bankrupts to the bankrupts' estate as represented by the Trustee.

Judge Smith said: The Court was attempting to predict how far the New York Courts would go in setting the limits of recovery on a type of claim which they had indicated would be held good, but which they had not as yet actually enforced. He believed the New York Courts would enforce the duty of an insurer to live up to his contractual obligation to use good faith in settlement negotiations. He would not expect them to require that the insured establish payment or ability to make payment

of an excess judgment. New York has demonstrated an interest in preventing insurance companies from avoiding payment on their policies on the ground of the insolvency of the insured (New York Insurance Law 167(1)(a) and (b)). Although the statute is keyed to the policy limits, it was originally enacted in 1917 when the problem of bad faith refusal to settle had not become the live issue it is today. He saw no sound reason for allowing the insurer to invoke the defense of insolvency to an action for breach of its duty to use good faith in settlement when it is denied such defense in actions for breach of the duty to pay within the policy limits. If the insured had been solvent, the majority's requirement for showing of damage presumably could have been met. However, the majority opinion left in doubt what would be necessary to establish damage and what would be the decision if the insured's net worth was only a percentage of the amount of the excess judgment. If the insured may have indemnity to some degree because of bad faith refusal to settle within policy limits, the coverage of the policy may be held to extend to the full amount of the judgment. In such situation an insured should not be required to show that he could satisfy the full amount of the judgment. Here the insurer's contract obligates it not only to pay the face amount of the policy but also to use good faith in settlement efforts. To say that there can be no damage to an insolvent for breach of the latter duty leaves the insured with an illusory protection. Furthermore, the majority assumed that the bankrupts were doomed to bankruptcy in any event. However, bankruptcy followed only after entry of the judgment. If the judgment had not been entered against them, the bankruptcy might not have been necessary and its effect on their future business prospects might have been avoided. The insurer deliberately exposed its insureds to the dan-

ger of the excess judgment. It should not be permitted to say that the resulting great increase in the insured's debts caused no damage because they might have had to go into bankruptcy in any event. Moreover, the majority's view of the nature of the damage from the breach of duty opens the distinct probability that the shaky financial condition of an insured will be used as an improper device for driving down settlements in serious injury and death cases below policy limits on threats of prolonged litigation at no risk to the insurer (R. 334a-337a)."

Reasons for Granting the Writ

1. The questions presented are of importance in the proper administration of federal bankruptcy laws. They are also of great importance to the insurance industry and to millions of motorists, and these questions recur often.

Section 70(a)(5), (6) of the Bankruptcy Act, 11 U. S. C. §110(a)(5), (6), vested in the Trustee the bankrupts' title to their right of action, which they could have transferred and which arose upon a contract or injury to the bankrupts' property. *4 Collier on Bankruptcy*, 1256.58 (14th Ed.); *Brown* v. *Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (1957).

Although the Trustee herein sought to enforce such a right of action [which arose from the breach of a contractual obligation of universal force underlying the policy of insurance, *Brassil* v. *Maryland Casualty Co.*, 210 N. Y. 235, 240, 241 (1914)], he has been barred from recovery by the decision of the Court of Appeals which does not rest upon any language in the bankruptcy laws.

In addition, the majority decision of the Court of Appeals may work injustice in many cases. Their re-

sult would depend on fortuitous circumstances. If the bankrupts had been able to pay some or all of the $89,000 excess judgment against them, then under the reasoning of the Court of Appeals the Trustee would have been able to recover for breach of the contractual obligation to exercise good faith in the settlement negotiations. However, because the bankrupts were so poor that they could not pay any portion of the excess judgment, the Trustee was not permitted to recover. Thus, the rights of creditors are made to depend on how much money the bankrupts were able to pay on an excess judgment prior to their petitions in bankruptcy. The adoption of such a rule merits review by this Court.

The result of the Court of Appeals decision may be that the greater the excess judgment against the future bankrupt the less likely will it be that the insurer which violated the contract of insurance will make good to the Trustee. The larger the amount of the excess judgment the less likely it is that the bankrupt can pay. As Judge Smith pointed out in his dissent, the result may be that the shaky financial condition of an insured may be used as an improper device by the insurer for driving down settlements in serious injury and death cases below policy limits and thus to remove assets from the hands of the bankrupts' creditors. Whether such a result is appropriate under the bankruptcy laws is a question of importance which this Court should decide.

2. This Court should determine whether the question of damage sufficient to sustain a right of recovery by a bankruptcy Trustee is a question of state or federal law.

The District Court found that under the Law of New York a party might recover for the failure of an insurer in bad faith to settle within the limits of an insurance

policy. The Court of Appeals did not reverse this view of New York law but apparently accepted it. On the question of damages the District Court said that the law of New York was unannounced and then determined the question as one of federal law. "But I do not think it desirable to impose a requirement of payment as a prerequisite to recovery in a case such as this where the insured is insolvent at the time of trial and is eventually forced into bankruptcy" (R. 313a). The Court of Appeals reversed the District Court on this point, saying that the Trustee "has failed to prove any damage whatever under New York Law" (R. 322a). Thus there is squarely posed the question whether damage such as will permit a trustee to recover is to be viewed as a question of state or federal law. This is a far-reaching question because the trustee represents creditors who will take a monetary loss if the Court of Appeals' rule is applied.

3. The decision of the Court of Appeals is untenable and probably in conflict with the New York State law as yet undeclared by the highest Court of that State. In *Brassil* v. *Maryland Casualty Co.*, 210 N. Y. 235 (1914), the New York Court of Appeals established that an insurer's liability to its insured was not measured by the letter of the insurance contract, but that underlying the written agreement was the obligation to exercise good faith. In *Best Building Co.* v. *Employers Liab. Assur. Corp.*, 247 N. Y. 451, 453 (1928), the Court decided that although an insurance company was not liable for a negligent failure to settle within the policy limits it would be liable for fraud or bad faith. The Court's prior decisions absolving the insurers from liability to their insureds for failure to settle within policy limits were all cases in which said Court stated there was no claim or suggestion of bad faith or did not consider the question

of bad faith. The question of damages—whether payment of the excess judgment is a prerequisite to action or whether the mere entry of the excess judgment establishes the damage and its measure—has not been passed upon by the New York Court of Appeals, and the New York rule has not been announced. However, the New York Court has recognized time and again that there may be an undertaking to indemnify against liability by judgment and not merely against damage resulting from payment of the judgment (*755 Seventh Avenue Corp. v. Carroll*, 266 N. Y. 157 (1935); *Conner v. Reeves*, 103 N. Y. 527 (1886); *Decker v. Mathews*, 12 N. Y. 313 (1885)). In view of the fact that there are no definitive New York decisions settling the question against the Trustee's claim and that the decision of the Court of Appeals herein is probably in conflict with the New York State law as yet undeclared, this Court should review the decision which bars a federal bankruptcy trustee from rights which an individual might have under New York law.

4. The instant decision of the Court of Appeals for the Second Circuit is apparently in conflict with decisions of the Court of Appeals for the Sixth Circuit (*Tennessee Farmers Mut. Ins. Co. v. Wood*, 277 F. 2d 21 (1960); *Shobbs v. Fidelity & Casualty Co.*, 259 Fed. 55 (1919)); and of the Court of Appeals for the Fourth Circuit (*Ley v. Nationwide Mut. Ins. Co.*, 286 F. 2d 295 (1961)). It is also in conflict with the applicable state authorities (*Southern Fire & Cas. Co. v. Norris*, 35 Tenn. App. 657, 250 S. W. 2d 785 (1952); *Heikes v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N. W. 2d 168 (1959); *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Delrample*, 270 Ala. 119, 116 So. 2d 924 (1959); *Communale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P. 2d 198 (1958); *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (1957);

Schwartz v. *Norwich Union Indemnity Co.*, 212 Wis. 593, 250 N. W. 446 (1933)).

In *Tennessee Farmers Mut. Ins. Co.* v. *Wood*, 277 F. 2d 21 (C. A. 6, 1960), the insured was insolvent—a poor man who owned no property except a horse and earned only $55 a week. Even though he was insolvent and had not paid any part of the judgment, the Court of Appeals for the Sixth Circuit held that he could recover for the insurer's bad faith refusal to settle within policy limits.

Forty-one years previously, in *Shambs* v. *Fidelity & Casualty Co.*, 259 Fed. 55 (C. A. 6, 1919), said Court of Appeals held that a policy insuring against loss from liability imposed by law, not containing any provision prohibiting action by the insured against the insurer until the insured had paid the judgment against him, was a policy indemnifying against liability of the judgment and not against loss suffered by payment of the judgment, and therefore payment was not a prerequisite. In that case the Trustee in Bankruptcy of a doctor sued an insurer which had defended the doctor unsuccessfully in a malpractice suit. A judgment of $10,000 had been entered against the doctor. He had never paid it, but filed a petition in bankruptcy. The sole creditor of the estate was the judgment creditor. The insurance company refused to pay the amount of the judgment to the Trustee on the ground that it was not required to do so unless the insured had actually satisfied the judgment. Since the insured had not paid the judgment, the insurance company said he could not have sustained loss. The policy contained no provision to that effect, just as the policy in the instant case did not.* The District

* The policy herein (Pl. Ex. 14; R. 102a, 299a, 300a) was a Combination Automobile Policy which required the insurer to pay any sum, within the limits of liability, which the insured should be legally obligated to pay as determined by judgment.

Court found for the insurance company, but the Court of Appeals reversed. It held that payment was not a prerequisite and that the Trustee was not limited to sums actually paid by the doctor, but that the entry of the judgment alone constituted a loss from liability on the basis of which the Trustee could sue and recover for the benefit of the bankrupts' estate.

In *Lee v. Nationwide Mut. Ins. Co.*, 286 F. 2d 295, (C. A. 4, 1961) the insured had died in an accident within the coverage of the policy issued by defendant insurer. The policy limit was $20,000. On the insurer's refusal to settle within the policy limit judgments were rendered against the insured's administratrix for $135,125. The administratrix sued for the insurer's negligent or bad faith failure to settle the claims within the limit of the policy. The District Court dismissed the complaint for failure to state a cause of action on the ground that the excess judgment had not been paid and that the meagre assets of the insured's estate ($1,441.48) were insufficient to satisfy the amount by which the judgments exceeded the coverage. The Court of Appeals reversed and remanded the case for trial, stating (286 F. 2d. at pp. 295, 296, 298):

> "Had the insured survived, even insolvent, the outstanding judgments, as constant and life-long threats to his financial security and rating, would have caused him almost immeasurable damage. Certainly, it would have rounded out his cause of action against the insurer for tort. * * *
>
> "The damage done to the estate is the creation of its liability for the judgments. Their holders are creditors equally with other persons with whom debts may have been incurred though not paid, such as medical and hospital expenses. The tort

origin of the judgments does not change their character as estate debts. They are nonetheless damages though they represent no contribution to the insured or his estate. The rule of damages, nearly universal, that incurrence is equivalent to outlay, is not restricted to any particular category of obligation. * * *

"More acceptable, as we noted at the outset, is the view treating the extant unpaid judgments as injuries in themselves, their overburden measuring the pecuniary damages."

The instant decision by the Court of Appeals for the Second Circuit which holds, to the contrary, that there is no right of action where the insured is insolvent and pays no part of the judgment, results in the insurer having no duty of good faith to a poor or insolvent insured, but a duty only to a wealthy insured. The insurer's duty of good faith and obligation to consider the interests of its insureds, thus would vary with and depend upon the financial condition of each insured, and we would have one law for the wealthy man and another law for the poor man—a situation intolerable under our system of law.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari be granted.

Respectfully submitted,

WILLIAM A. HYMAN,
Attorney for Petitioner.

Dated, February 20, 1962.

APPENDIX

Opinion of the District Court

(Filed February 10, 1961. Reported in 191 F. Supp. 538)

IRVING R. KAUFMAN, D.J.

Plaintiff, the trustee in bankruptcy of Leonard and William Massello, brings this action to recover damages for defendant's refusal, allegedly in bad faith, to settle a personal injury action brought against the Massellos, within the limits of a liability insurance policy issued by the defendant to Leonard Massello.

I.

This action stems from an automobile accident which occurred on January 5, 1952, when a panel truck owned by Leonard Massello and driven by William Massello collided with a taxicab at the intersection of Palisade Avenue and Shonnard Place in Yonkers. As a result of the collision, the taxicab was forced onto the sidewalk, where it struck a passing pedestrian, Mrs. Elizabeth Pease Van Suetendael, causing her serious injuries. Mrs. Van Suetendael then instituted suit in the New York Supreme Court, Westchester County, against the owners and drivers of both vehicles, to recover damages for these injuries.[1]

Pursuant to the terms of the automobile liability insurance policy issued by the defendant to Leonard Massello, Standard Accident and Insurance Company assumed

[1] Mrs. Van Suetendael's husband joined in the action, claiming damages for loss of services and medical expenses. Prior to the trial, the husband died, and Mrs. Van Suetendael, as executrix of his estate, was substituted as plaintiff in his place.

the defense of the action on behalf of the Massellos. The coverage under this policy was limited to $10,000 for any one person injured in any one accident.

Settlement discussions were had in the State court action prior to the trial in pre-trial conferences, and during the course of the actual trial. However, no agreement could be reached, and after a trial in the month of March, 1957, before Justice George Fanelli of the Supreme Court and a jury, a verdict awarding $105,000 damages for the plaintiff, individually and as executrix, against all defendants, was returned, and judgment was entered thereon. Subsequently, Standard paid Mrs. Van Suetendael the sum of $10,000, the limit of its policy, and Travelers Insurance Company paid, on behalf of the taxicab owner, the sum of $5,000, the limit of its policy. The taxicab owner personally paid an additional $1,000, and received a release of the lien of the judgment against him. Thus, the sum of $89,000 remains due upon the judgment.

Meanwhile, subsequent to the judgment in the personal injury action, the Massellos filed petitions in bankruptcy in the United States District Court for this district, and were adjudicated bankrupts. On September 13, 1957, plaintiff was appointed trustee in bankruptcy. The bankruptcy proceedings have remained open, pending the outcome of this action.

II.

Plaintiff's case is premised on the contention that defendant's refusal to settle was in bad faith, a theory of liability that is recognized in New York, *Best Building Co. v. Employers' Liability Assurance Corp.*, 247 N. Y. 451 (1928), as well as in most other jurisdictions. See, e.g., *Tennessee Farmers Mutual Ins. Co. v. Wood*, 277 F. 2d 21 (C. A. 6, 1960); *Henke v. Iowa Home Mutual Cas-*

uality Co., 250 Iowa 1123, 97 N. W. 2d 168 (1959); *Communale* v. *Traders & General Insurance Co.*, 50 Cal. 2d 654, 328 P. 2d 198 (1958). See generally Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv. L. Rev. 1136 (1954).[2]

The necessity for a principle of liability in this area stems from the fact that under the terms of the ordinary liability insurance policy, the insurer has the duty of defending actions brought against the insured within the scope of the policy. This duty confers upon the company the exclusive control over all decisions concerning settlement. In making these decisions, the company, since it is, in actuality, representing both itself and its insured, is faced at times with the reconciliation of inevitably conflicting interests. For example, a settlement within the limits of the policy coverage would generally be advantageous to the insured, since he would then not be subject to any excess personal liability. On the other hand, it would often be desirable for the company to proceed to trial, and seek to avoid liability, particularly where its risks are limited by the policy coverage to a relatively small sum. This, however, would often expose the insured to the possibility of a substantial personal liability.

Since the company, therefore, has power, through the control of settlement, to adversely affect the insured's interests it must necessarily bear a legal responsibility for the proper exercise of that power. Thus, the law im-

[2] Some jurisdictions require the insurer to meet a more stringent standard in determining whether to settle. In these jurisdictions, the insurer will be liable to the insured if the refusal to settle was the result of negligence or the failure to exercise ordinary care. See, e.g. *Dumas* v. *Hartford Accident & Indemnity Co.*, 94 N. H. 484, 56 A. 2d 57 (1947). New York, however, allows liability only if bad faith toward the insured is shown. *See Best Building Co.* v. *Employers' Liability Assurance Corp.*, 247 N. Y. 431 (1928); *Gucci & Diaz, Inc.* v. *Liberty Mutual Ins. Co.*, 147 N. Y. S. 2d 806 (Sup. Ct. 1955)

poses upon the insurer the obligation of good faith—basically, the duty to consider, in good faith, the insured's interests as well as its own when making decisions as to settlement.

Bad faith—the failure to comply with this obligation—is generally proven by evidence largely circumstantial in nature. It is most readily inferrable when the severity of the plaintiff's injuries is such that any verdict against the insured is likely to be greatly in excess of the policy limits, and further when the facts in the case indicate that a defendant's verdict on the issue of liability is doubtful. See, e.g. *Tennessee Farmers Mutual Ins. Co. v. Wood*, 277 F. 2d 21 (C. A. 6, 1960); *Henke v. Iowa Home Mutual Casualty Co.*, 250 Iowa 1123, 97 N. W. 2d 168 (1959). When these two factors coincide, and the company still refuses to settle, the inference of bad faith is strong.

In the instant case, the defendant contends that it exercised good faith throughout; that it determined to proceed to trial because of a bona-fide belief that liability could be avoided. The company further seeks to excuse its failure to settle on the theory that, since it knew the Masselos were insolvent, it was not exposing them to any substantial risk in proceeding to trial.

An examination of the evidence introduced at the instant trial indicates conclusively, however, that the defendant company, and its attorney, failed to give adequate consideration to the interests of the Masselos. Not only did the objective criteria—the severity of the injuries and the probability of the plaintiff's verdict—coincide, but statements made by defendant's trial attorney during the course of the personal-injury action clearly illustrate the bad-faith approach by the company to the defense of that action.

III.

Several witnesses were called by the trustee in the trial before this court to substantiate his version of the facts. Justice Fanelli, one of these witnesses, testified that a settlement conference was held before him at the time of the selection of the jury and that at least one more such conference was held during the course of the trial. He testified:

that at the first conference, Mr. William A. Hyman, representing Mrs. Van Suetendael, outlined the essentials of his case to the judge and to the attorneys for the defendants;

that Hyman emphasized, through the bill of particulars, the severity of the plaintiff's injuries;

that Hyman further noted the inconsistencies in testimony given by William Massello in his examination before trial and in a Motor Vehicle Bureau hearing;

that Hyman indicated that he had available a disinterested eyewitness who would give testimony which would be very damaging to the Massellos;

that he (Justice Fanelli) during this pre-trial conference indicated his belief that both defendants would be held liable, and that the defendants could not win the case;

These three witnesses were such as to create some doubt as to Massello's credibility in the case before the Motor Vehicle Bureau. Massello testified that the truck driver had turned his steering wheel to the right and that the rear wheel of the truck had struck the right front bumper of the pick-up truck. Subsequently, on his examination before trial, Massello testified that the two trucks were about parallel to one another when the rear wheel of the truck struck the left rear bumper of the truck. There were no witnesses other than the two of Massello's testimony.

that he, therefore, recommended a settlement to all parties;

that Mr. James O. Denniston, the attorney representing the Travelers Insurance Company, agreed that all defendants were liable, and offered to contribute the full amount of Travelers' policy coverage, $5,000, towards a settlement;

that he (Justice Fanelli) inquired of Standard's counsel as to his position;

that Standard's counsel replied that he would only match the Travelers' contribution;

that he (Justice Fanelli) again expressed his opinion that the defendants could not win the case;

and that Standard's counsel replied that he knew he couldn't win, but that he had no authority to contribute any more than Travelers.[1] (See Record, pp. 5-12.)

Justice Fanelli further testified:

that at the second settlement conference held before him, he again told Standard's counsel that he did not believe the defendants could win the case; that he further indicated that Mr. Hyman was now willing to settle for a sum below the combined pol-

[1] Standard's attorney testified at this trial that he never made any statements indicating his belief that the Masellos would be held liable, and that in fact he believed that the case could be won. However, Justice Fanelli, a witness with no interest in the outcome of this litigation, testified unequivocally that the attorney did state that he knew he couldn't win the case. This testimony was corroborated by Mr. Hyman. Mr. Denniston, a witness without any interest in this litigation also confirmed this. Upon hearing the witnesses, and observing their demeanor, I conclude that the evidence given by the witnesses called by the plaintiff is more persuasive.

icy limits, and thus that Standard would be able to save a small amount on its policy coverage;

that Standard's position, however, remained unaltered;

and that its attorney repeated that he had no authority to contribute any more than was contributed by the Travelers Insurance Company—$5,000. (Record, pp. 12-14.)

The testimony of Justice Fanelli with respect to these incidents was fully corroborated by testimony given by Mr. Denniston and Mr. Hyman (Record, pp. 48-59, 97-99, 101-04).[3]

The attorney for Standard maintained his position throughout the course of the trial of the negligence action, and reiterated it several times in discussions with Mr. Denniston and Mr. Hyman. Even after the "disinterested" witness mentioned by Mr. Hyman testified, giving testimony strongly indicating that the Massellos were liable, Standard refused to alter its position with regard to settlement.

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[3] Mr. Hyman also testified as to a conversation with Standard's attorney during the course of the trial. He testified:

that Standard's counsel asked Mr. Hyman whether he would be satisfied with a $5,000 contribution from Standard;

that when he refused, and asked Standard's attorney whether he would reconsider the suggestion made by Justice Fanelli, the attorney again reiterated that he would only match Travelers' contribution;

and that Standard's attorney further said that under the circumstances, "we will have to finish this trial, we've got nothing to lose" (Record, pp. 60-61).

This attitude of intransigence and the failure to understand its responsibility to the insured, was evident even before the trial. Thus, Mr. Hyman testified to a meeting with Mr. George Wadkinson, the supervisor of defendant's Liability Claim Department, approximately one year before the trial. At this time, according to Mr. Hyman's testimony, Mr. Wadkinson told Mr. Hyman that, with respect to settlement of the case, Standard would only match the contribution of Travelers (Record, pp. 71-72). Further, Mr. Harris, the trustee, testified as to pre-trial proceedings held in April of 1956. At that time, Official Referee Schmidt, a former Supreme Court Justice, recommended that the case be settled, with a slight saving to each insurance company on its policy coverage. Travelers' representative indicated that he would pay $4,500; the defendant's representative then said that he had no authority other than to meet Travelers' contribution (Record, pp. 125-29). Thus, the early pre-trial negotiations ultimately were unsuccessful.

IV.

The defendant's arbitrary equation, throughout the case, of the amount it was willing to pay with that offered by the Travelers Insurance Company, despite factual distinctions and differences in policy coverage, cannot conceivably be reconciled with a good-faith consideration of the interests of the insured. Certainly, there can be no rational correlation between the insured's interests and potential liabilities, and the amount offered by another insurance company with a different policy coverage. Standard acted throughout as if the matter of prime importance was not to pay one penny more than Travelers towards the settlement, and this obsession apparently blinded it to its correlative obligation to the in-

sured.[6] Furthermore, it seems clear throughout, that the defendant knew that its chances of success on the issue of liability were minimal.[7]

Both Official Referee Schmidt and Justice Fanelli had suggested settlement, and Justice Fanelli specifically indicated his belief that neither defendant had any chance of winning. In addition, Standard's attorney admitted that Mrs. Van Suetendael's injuries were very substantial, and, therefore, that any verdict for the plaintiff would be far

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[6] For example Mr. Denniston, the Travelers' attorney, testified as to a conversation he had with Standard's attorney. He testified:

> that Standard's counsel told him that he had information that Travelers in fact had a $10,000 limitation on its policy;
>
> and that Standard's attorney offered to contribute the full amount of its policy—$10,000—if Travelers would also contribute $10,000.

Mr. Denniston testified further that he advised Standard's attorney that the attorney's information was incorrect and that he had never misled or lied to anyone particularly to a Supreme Court Judge (Record, pp. 99-100).

[7] The Company argues that there was substantial probability of avoiding liability, if the jury believed that the panel truck driven by William Masello had been standing still at the time of the accident. But William Masello admitted at all times that he had moved out into the intersection after first making a stop at a stop sign. The controversy was in connection with whether he had made a second stop, and was standing still when the vehicles collided. In this regard, the discrepancies in Masello's testimony which were pointed out in the settlement conference cast strong doubt on his contentions. In any event, as Justice Fanelli indicated at the first settlement conference before him, if the defendant was even one percent negligent, as he well might be in merely proceeding into the intersection after first stopping at the stopping at the stop sign, he would be liable for the full amount of plaintiff's damages. In addition, the so-called disinterested eyewitness testified that the truck had been moving forward at the time of the collision, and that it struck the taxicab.

in excess of the combined policy coverage.[8] (See Record, pp. 247-48.) Thus, the financial risk to the insured was great, while the possibility of escaping liability was indeed slight at best. Standard's counsel was obviously aware of both of these factors at the time of the settlement negotiations, as the testimony of Justice Fanelli, Mr. Denniston, and Mr. Hyman clearly indicates.[9] In this situ-

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[8] The bill of particulars, which was never disputed by any party in the personal-injury action, indicates the severity of Mrs. Van Suetendael's injuries. The bill details her injuries as follows:

> crushing compound comminuted fracture of the right tibia with overriding of fragments; complete internal rotation of distal leg on proximal leg; fracture of large segment of fibula with angulation, separation and non-union of fragments; avulsion of skin from right foot to knee; multiple fine stones and cinders ground into right leg; shortening of the right leg; deformity of the right leg; loss of muscle and soft tissue of the right leg; loss of circulation of right leg; results of loss of circulation; hyperkeratosis; pigmentation; tautness; scaliness and cracking of skin right leg; scars of right leg; limitation of motion of right leg; limitation of motion of right foot and ankle; deformity of right foot; limp; scar of left ankle; curvature of the spine; deformity of back; shock; pain, injury to nerves and nervous system.

In addition, many of these injuries were alleged to be permanent. The bill of particulars indicated special damages in the sum of approximately $8500. In the settlement conference, Justice Fanelli fixed the special damages between $9,000 and $10,000 (Record, p. 11). Standard's attorney testified at this trial that he realized at all times that the injuries were very substantial, and in fact, that when he saw Mrs. Van Suetendael in court, his estimate as to the severity of her injuries increased (Record, pp. 247-48).

[9] The defendant argues, in connection with the statements of its counsel, that he had no authority to settle the case, and thus that the statements cannot be attributed to the company. But, as attorney for the company, he certainly had authority, be it termed apparent or implied, to appraise and discuss the case during the course of settlement negotiations, an ordinary and usual occurrence in virtually every case of this nature.

ation, it is difficult to attribute the refusal to consider a settlement within the policy limits to anything other than bad faith. See *Bell v. Commercial Insurance Co.*, 280 F. 2d 514 (C. A. 3, 1960).

The inference is inescapable that the defendant failed to give adequate, if any, consideration to the interests of its insured. Its attitude, as manifested throughout by its counsel, was that it had nothing whatsoever to gain from a settlement approximating the policy limits and nothing to lose by going to trial for it would under no circumstances be compelled to pay more than $10,000. Thus, it determined to proceed to trial, exposing the insured to a financial risk completely disproportionate to the possibility of success. Highly significant, in this respect, is the fact that neither the attorney nor any other representative of the defendant ever informed the Massellos that a settlement within the policy limits, thus avoiding any risk of the personal liability, was possible. (See Record, pp. 162, 277, 283, 328-29, 336-37.)[10] See also

[10] The defendant urges that the Massellos insisted to its attorney throughout the trial, that they were not liable for the accident (See Record, pp. 281-82, 534-35). But the Massellos testified not only that they were never informed of the settlement possibilities, but also that they never told Standard's attorney not to settle the case (Record, pp. 550, 537). In any event, the attorney, in determining whether to proceed to trial, must make an objective appraisal of the facts and the relevant law. The attorney's judgment must be that of an informed expert, acting in good faith and not that of interested laymen, such as the Massellos were. Parties to a suit can hardly be expected to make an objective appraisal of the facts and law in their own case. They are acting without expertise and usually view their position from a partisan and emotional point of view. The attorney, therefore, is expected to bring to the case the objectivity and expertise which the parties lack. This is especially important in the instant case, since Standard's attorney has considerable experience, and has been engaged almost exclusively in negligence and casualty litigation for 18 years (Record, p. 179). In this situation, the failure to settle certainly cannot be excused on the ground that the Massellos maintained they were not liable

Jarrett, Lawsuits for Wrongful Refusal to Defend or to Settle, 1961 Ins. Counsel J. 58, 64. This is scarcely consistent with a diligent effort to protect the insured's interests.

Neither, am I persuaded by the defendant's argument that, since it knew that the Massellos were insolvent, and thus that the recovery of a substantial amount from them was unlikely, its decision to proceed to trial was reasonable. I do not believe that the financial condition of the insured is a relevant consideration when the company is making a good-faith determination as to whether to settle. See Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv. L. Rev. 1136, 1146 n. 24 (1954). Certainly, the risk of bankruptcy is not an insubstantial one; if a person is caused, by a substantial judgment entered against him, to file a petition in bankruptcy, this is likely to eventuate in considerable future embarrassment and impairment of credit. This is certainly not an element which the company can be permitted to consider lightly. Further, it is not the function of the insurer, when undertaking the defense of an action, to ascertain the financial condition of its insured and to consider that factor in making a determination to defend. The decision as to whether to settle or proceed to trial should be made on the basis of an objective appraisal of the possibility of success; other extraneous considerations should be disregarded. Thus, a determination not to settle should be made only upon a bona-fide belief that there is a real likelihood of prevailing in the action. See *Bell v. Commercial Insurance Co.*, 280 F. 2d 514 (C. A. 3, 1960).

It is clear that all of the criteria for a finding of bad faith are present in this case. I hold, therefore, that the defendant acted in bad faith in refusing to settle the personal injury action within the policy limits.

V.

I next come to the question of damages. There appears to be a split among the jurisdictions as to whether payment of the excess judgment by the insured is a prerequisite to recovery of damages. See Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv. L. Rev. 1136, 1173-75 (1954), although the more recent cases seem to adopt the view that the entry of the judgment against the insured is sufficient in itself to warrant recovery of the amount of the excess from the insurer. See, e.g., *Henke v. Iowa Home Mutual Casualty Co.*, 250 Iowa 1123, 97 N. W. 2d 168 (1959); *Communale v. Traders & General Ins. Co.*, 50 Cal. 2d 654, 328 P. 2d 198 (1958); *Southern Fire & Casualty Co. v. Norris*, 35 Tenn. App. 657, 250 S. W. 2d 785 (1952). New York State has, apparently, not yet adopted any rule on the question of damages.

I do not, at this time, express any preference for either of these two rules. But I do not think it desirable to impose a requirement of payment as a prerequisite to recovery in a case such as this, when the insured is insolvent at the time of trial and is eventually forced into bankruptcy. If payment were a prerequisite in such a situation, the company could easily avoid the duty of good faith owed to the insured. For example, if the company knew, as it presumably would, of the insured's poor financial condition, it would then risk little by proceeding to trial regardless of the chances of success. Since the likelihood of payment of the excess by the insured would be slight, the chance of an ultimate recovery over of the excess against the insurer would be minimal. Thus, to require payment as a prerequisite would be to emasculate the important substantive policies underlying the obligation of good faith, at least in a case in which the insured's financial status renders payment impossible or

unlikely. As the court stated in *Southern Fire & Casualty Co.* v. *Norris, supra,*

> "The contrary view, while logical in the abstract, only serves as a windfall to an insurer fortunate enough to have insured an insolvent. The insurer in such a case stands in the position of having been derelict in the performance of its duty under a policy for which it accepted a premium paid by the insured in good faith * * *. If the insured had not felt the need of the protection offered by the policy and the services of the Company in handling claims against him it is to be assumed that he would not have taken the policy. The claim is now an adjudged liability which he can escape only by a discharge in bankruptcy or by payment. If he chooses the former course his credit is impaired. If he does not the outstanding judgment against him is likely to prove an insurmountable barrier to payment. If prepayment is required in cases of this kind the insurer is likely to be less responsive to its trust duties in cases where the insured is insolvent than in cases where the insured is able to discharge any judgment in excess of the policy limit which may be rendered against him." 250 S. W. 2d at 791.

Moreover, allowing recovery from the insurer in this case would not result in an unwarranted windfall to the Massellos. The bankruptcy proceedings have been left open pending the outcome of the litigation. The cause of action properly passed to the trustee, and is thus being maintained for the benefit of the bankrupt's estate. See 4 Collier on Bankruptcy, 1256-57 (14th ed.); *Brown* v. *Guarantee Insurance Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (1957). Cf. *Communale* v. *Traders & General Ins.*

Co., supra. Thus, the recovery will inure to the benefit of the trustee, rather than the Massellos, and will be available for the payment of claims of creditors, including, presumably, that of Mrs. Van Suetendael.

Thus the plaintiff is entitled to recovery of the full amount of the unpaid judgment, $89,000, and judgment will enter accordingly. The foregoing opinion will constitute the court's findings of fact and conclusions of law.

Dated: New York, N. Y.
February 10, 1961.

IRVING R. KAUFMAN,
U. S. D. J.

Majority Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

—o—

No. 38—September Term, 1961.

(Argued September 28, 1961 Decided December 6, 1961.)

Docket No. 26892

—o—

MELVILLE HARRIS, as Trustee in Bankruptcy of LEONARD MASSELLO and WILLIAM MASSELLO,
Plaintiff-Appellee,

—v.—

STANDARD ACCIDENT AND INSURANCE COMPANY,
Defendant-Appellant.

—o—

Before:

LUMBARD, *Chief Judge,*
FRIENDLY and SMITH, *Circuit Judges.*

—o—

WILLIAM A. HYMAN, New York, N. Y. (Harold W. Hayman, on the brief), *for plaintiff-appellee.*

MAURICE ROSENBERG, New York, N. Y. (Reid A. Curtis, James B. Donovan, Patrick J. Hughes, and Watters & Donovan, on the brief), *for defendant-appellant.*

—o—

LUMBARD, *Chief Judge*:

Plaintiff, the trustee in bankruptcy of Leonard and William Massello, brought this action to recover damages for defendant's refusal, allegedly in bad faith, to settle a personal injury action brought against the Massellos, within the limit of a $10,000 automobile liability insurance policy issued by the defendant, Standard Accident and Insurance Company. The district court awarded $89,000 damages, and Standard appeals. Since there was no showing that the insured suffered any loss, we reverse the judgment of the district court. In view of this, it is unnecessary for us to determine whether New York law recognizes a cause of action for refusal to settle under the circumstances of this case.

Standard issued an automobile liability insurance policy to Leonard Massello with a limit of liability of $10,000 for any one person for any one accident.[1] On January 5, 1952 William Massello, while driving a panel truck owned by his brother Leonard, collided with a taxicab in Yonkers, New York. As a result of this collision, the taxicab ricocheted onto the sidewalk where it struck a pedestrian, Mrs. Elizabeth Pease Van Snetendael, inflicting serious injuries. Mrs. Van Snetendael sued the owners and drivers of both vehicles in the New York Supreme Court. Pursuant to the policy, Standard assumed the defense of the action on behalf of the Massellos. Although numerous settlement

[1] The plaintiff introduced in evidence a sample policy which was in identical form to that issued to Leonard Massello. Under this policy, the "'insured' includes the named insured and also includes any person while using the automobile * * * with his permission." Standard agrees to "defend any suit against the insured." Furthermore, Standard "may make such * * * settlement of any claim or suit as it deems expedient" and "the insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense * * *."

discussions were had both before and during the trial, no settlement was reached and, after a trial in March 1957, the jury brought in a $105,000 verdict for Mrs. Van Suetendael upon which Judge Fanelli entered judgment. Standard paid Mrs. Van Suetendael the sum of $10,000, the limit of its policy; the Travelers Insurance Co. paid on behalf of the taxicab owner the sum of $5,000, the limit of its policy; and the taxicab owner personally paid an additional $1,000, receiving a release of the lien of the judgment against him. The sum of $89,000 remained uncollected upon the judgment,[1a] and for this amount the trustee brought suit against Standard.

Even before entry of the Van Suetendael judgment, the Massellos were insolvent. In August 1956 they had lost their business to creditors. Subsequent to the entry of judgment, the Massellos filed petitions in bankruptcy in the United States District Court for the Southern District of New York and were adjudicated bankrupts. Although the Massellos were discharged in bankruptcy on November 17, 1958, the bankruptcy proceedings have remained open pending the outcome of this damage action against Standard.

The district judge tried the case without a jury. Judge Fanelli of the New York Supreme Court, who had presided at the personal injury trial, testified that when he told Standard's counsel, Reid Curtis, that he thought all the defendants would be held liable and that Standard could not win, Mr. Curtis replied that he knew it. Mrs. Van Suetendael's attorney, William Hyman, testified that Mr. Curtis told him that since Standard had nothing to lose, he would finish the trial. Although Mr. Curtis denied these statements, the district judge credited Judge Fanelli

[1a] Hereinafter this amount in excess of the policy coverage will be referred to as the excess judgment

and Mr. Hyman. William Massello, the driver of the truck, at all times contended that he was not responsible for the accident and both Massellos admitted that since they were already insolvent, they could not pay any excess judgment.

The district court held that since the insurer had exclusive control of settlement, it had an obligation to consider, in good faith, the insured's interests as well as its own when making decisions as to settlement. In light of the severity of Mrs. Van Suetendael's injuries and the probability of a verdict in her favor, coupled with the statements made by Standard's trial attorney during the personal-injury action, the judge concluded that the trustee in bankruptcy had a cause of action for Standard's bad faith in its conduct of the defense. The district court held that payment by the insured should not be a prerequisite to recovery as the insurer could then "easily avoid the duty of good faith owed to the insured." 191 F. Supp. at 544. He pointed out that New York had not yet adopted any rule on damages in such a case and cited Iowa, California and Tennessee authority to support his view that entry of judgment was sufficient.

The district court had jurisdiction under 23(b) of the Bankruptcy Act, 11 U. S. C. § 46(b), which gives federal courts jurisdiction of suits brought by the trustee provided the defendant consents.[2]

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[2] The record does not disclose facts upon which diversity jurisdiction could rest. The complaint alleges only that the plaintiff trustee in bankruptcy is a citizen of New York, that the defendant Standard is incorporated in Michigan and that more than $10,000 is in controversy. The district court did not discuss jurisdiction nor did the parties brief it on this appeal. According to the Bankruptcy Act, 11 U. S. C. § 46, the citizenship of the bankrupt and not that of the trustee is relevant in determining diversity. Moreover, under 28 U. S. C. § 1332(c), which applies to suits commenced after July 25, 1958, a corporation is deemed a citizen of the state where it is located for pur-

The courts have increasingly recognized a duty on the insurer to exercise some degree of care or good faith toward the insured in deciding whether to settle, although most contracts of insurance merely give the insurer the sole right to settle actions arising within the coverage of the policy but do not require it to do so. The interests of the insured and insurer often conflict. A settlement within the limits of the policy coverage is usually advantageous for the insured, for then he avoids all risk of personal liability for a judgment in excess of the policy limits. On the other hand, rather than consent to a settlement which would require the payment of substantially the entire amount of its coverage, the insurance company would generally prefer to proceed to trial and seek to avoid liability; should it lose, it may not be liable for much more than it would have had to pay in settlement. Consequently, the majority of jurisdictions which have ruled on the point do impose a duty upon the insurer in some situations where it has failed to give appropriate weight to the insured's interests.[3]

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cipal place of business. Although this action was filed on October 15, 1958, there is no allegation as to Standard's principal place of business. Therefore, the facts necessary to diversity jurisdiction both as to the bankrupts and Standard are lacking. Nevertheless, the district court had jurisdiction on another basis. 23 Bankruptcy Act §2(a)(6), 11 U. S. C. §46(a), gives federal courts jurisdiction over all suits brought by a trustee in bankruptcy if the defendant consents. See *Schumacker* v. *Beeler*, 293 U. S. 367 (1934). The courts have held that a defendant consents if he argues the merits without objection to jurisdiction. *See, e.g., Cline* v. *Kaplan*, 323 U. S. 97 (1944); *Toledo Fence & Post Co.* v. *Lyon*, 290 Fed. 637, 640 (6 Cir. 1923); *Scogmiller* v. *Day*, 249 Fed. 177, 178-79 (7 Cir. 1918); *In re Real York, Inc.*, 152 F. 2d 513 (7 Cir. 1945); *In re Berry*, 247 Fed. 700, 704-5 (E. D. Mich. 1917).

[3] See, e.g., Keeton, Liability Insurance and the Responsibility for Settlement, 67 Harv. L. Rev. 1136, 1148 (1954); Wymore, Safeguarding Against Claims in Excess of Policy Limits, 28 Ins. Counsel J. 44, 48-57 (1961) (catalog of cases).

Standard's duties and liabilities in this case are governed by the law of New York,[4] and this the parties do not dispute. But we do not pause to discuss whether the New York courts would hold Standard liable in this situation.[5] The plaintiff has failed to prove any damage whatever under New York law. Therefore we reverse the judgment of the district court and direct that the complaint be dismissed. In the discussion of damages to which we now turn, we assume *arguendo* that the plaintiff has otherwise made out a sufficient case for recovery.

New York's insurance statutes, relied upon by Judge Smith in his dissenting opinion, have no persuasive effect as to what constitutes such damage to an insured as to render the insurer liable on an excess judgment. There are two types of insurance policies, those indemnifying the insured against liability and those indemnifying against loss.[6] In order for the insured to recover against the insurer under the first type, the insured need prove only that a judgment has been entered against him. On the other hand, policies of the second type require proof that a loss has actually been suffered. To emphasize the nature

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[4] *See, e.g., Hauseman v. Insurance Co.*, 71 U. S. (4 Wall.) 49, 67 (1866); *Ingersoll v. Williams*, 196 F. 2d 697, 699 (C.A. 2d Cir.), *cert. denied*, 343 U. S. 929 (1952); Hill, The Erie Doctrine in Bankruptcy, 32 Harv. L. Rev. 261, 264, 268, 48 (1955).

[5] It is not clear whether New York would hold that Standard had violated its duty to its insured under the facts of the case. *See Ingersoll v. Standard Oil Co. (Ind.)*, 230 N. Y. 347, 130 N. E. 577 (1921); *Best Building Co. v. Employers' Liability Assur. Corp.*, 247 N. Y. 451, 160 N. E. 911 (1928); *Standard Oil Co. v. Frankfort Gen. Ins. Co.*, 237 N. Y. 60, 142 N. E. 435 (1923); *Bonanza Realty Co. v. Frankfort Ins. Co.*, 99 Misc. 659, 166 N. Y. S. 1 (Sup. Ct. 1917). No case bearing upon this question has been decided by the New York Court of Appeals since the *Ingersoll* case in 1921.

[6] *See Sarato v. Rock Co. v. Standard Ins. Co.*, 145 App. Div. 855, 856, 130 N. Y. S. 823 (1911), 37 N. Y. R. 644 (1925).

of this type of policy, insurance companies often insert provisions that the insured shall not recover from them until he has actually paid a judgment against him. Because of an increasing feeling that automobile liability insurance should protect the injured person as well as the negligent driver,[7] coupled with the idea that having received the premiums the insurance company should not avoid liability to a person injured within the scope of the policy merely because the insured was unable to pay, the legislatures of New York and many other states have prohibited this type of policy in certain situations.[8] The New York statute, first enacted in 1917,[9] prohibits the use of the insured's insolvency or bankruptcy as a defense to the insurance company and creates a cause of action by the injured person directly against the insurer if the former's judgment against the insured remains unsatisfied for 30 days. Standard's policy issued to Leonard Massello incorporates these provisions. Pursuant thereto, Standard paid Mrs. Van Suetendael's judgment against the Massellos to the extent of the limit of coverage of the policy, $10,000. It is to be noted, however, that this New York statute explicitly prohibits use of the insured's insolvency or bankruptcy as a defense only to the face amount of the policy; it does not forbid such defense as to the excess judgment.

The reasons for the enactment of the statute warrant its application to the coverage of the policy only and not to

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[7] See, e.g., *Lauritano v. American Fidelity Fire Ins. Co.*, 3 A D 2d 564, 567-68, 162 N. Y. S. 2d 55, 58-59 (1957), aff'd without opinion, 4 N. Y. 2d 1028, 177 N. Y. S. 2d 520 (1958).

[8] See, e.g., *Guerin v. Indemnity Ins. Co. of North America*, 107 Conn. 649, 142 Atl. 268 (1928).

[9] Laws of 1917, Ch. 524, New York Insurance Law §109; now New York Insurance Law §167(1)(a), (b); see *Coleman v. New Amsterdam Cas. Co.*, 247 N. Y. 271, 160 N. E. 367 (1928).

the excess liability. The argument that insurance should protect the injured person as well as the insured applies only to the extent that the insured has taken out insurance. The argument that having received premiums the insurance company should not be relieved of liability because of the insured's bankruptcy does not apply to the excess judgment since the insurer has received premiums only for the face amount of the policy, here $10,000. If as our dissenting colleague suggests we are to decide this case on "the spirit of New York's concern for the injured victim" we would be usurping the function of New York's legislature. Perhaps New York should require those in the trucking business to carry more adequate liability insurance. But so long as the state leaves in the hands of the potential wrongdoer the amount of insurance he shall carry, courts should not depart from well settled principles of tort law and damages in order to impose a liability for which the parties did not contract. Therefore, the New York insurance law does not require Standard to pay the excess judgment against the Masselloses: proof of tort damages is necessary.

The law of New York requires proof of actual loss to support recovery for a tort of his type. The purpose of tort damage is to compensate an injured person for a loss suffered and only for that.[10] The law attempts to put the plaintiff in a position as nearly as possible equivalent to his position before the tort.[11] Recovery is permitted not

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[10] *Rogers v. Ball*, 289 N. Y. 358, 365, 46 N. E. 2d 333, 336 (1943); *Kuczma v. Southern Cal. Rapid Transit Dist.*, 63 Misc. 2d 1064, 314 N. Y. S. 2d 787, 797 (Sup. Ct. 1970); *Hall v. Marshall Ind. Corp.*, 241 N. Y. 27, 148 N. E. 781 (1925); *Hansen v. Bradley*, 140 N. Y. S. 2d 716 (Sup. Ct. 1955), modified 5 A. D. 2d 1011, 187 N. Y. S. 2d 254 (1958).

[11] Restatement, Torts, 901 and comments.

in order to penalize the tortfeasor,[12] but only to give damages "precisely commensurate with the injury."[13]

The trustee argues that although the Massellos were insolvent before the rendition of the excess judgment, have never paid any part of it, and have been discharged from liability for it by bankruptcy, they have nevertheless been injured by it to the extent of $89,000, the face amount of the excess judgment. The New York courts have not passed on this question. The courts of other states have split on whether the insured is damaged by an uncollectible excess judgment against him.[14] In the leading case of *Dumas* v. *Hartford Acc. & Indem. Co.*, 92 N. H. 140, 26 A. 2d 361 (1942), the New Hampshire court held that since an actual injury, rather than the mere possibility of an injury, is a prerequisite to a tort recovery, either the insured must pay the excess judgment or his financial status must be such that it is sure to be collected. See also *Universal Auto. Ins. Co.* v. *Culberson*, 126 Tex. 282, 86 S. W. 2d 727 (1935); *State Auto. Mut. Ins. Co.* v. *York*, 104 F. 2d 730, 734 (4 Cir.) (alt. holding), cert. denied, 308 U. S. 591 (1939); *Norwood* v. *Travelers Ins. Co.*, 204 Minn. 595, 284 N. W. 785 (1939); Restatement, Torts, 871, comment (j); cf. *American Mut. Liab. Ins. Co.* v. *Cooper*, 61 F. 2d 446 (5 Cir. 1932), cert. denied, 289 U. S. 736 (1933); *Boling* v. *New Amsterdam Cas. Co.*, 173 Okla. 160, 46 P. 2d 916 (1935). But see 8 R. C. L. p. 500. Those cases which apparently hold that the rendition of an excess judgment is sufficient damage to permit a recovery for the amount of the unpaid judgment are all distinguish-

[12] *Victor A. Harden Realty & Constr. Co.* v. *City of New York*, 64 N. Y. S. 2d 310, 322 (Sup. Ct. 1946).

[13] *Greenman* v. *Morning Journal Assn.*, 197 N. Y. 474, 480, 90 N. E. 1151, 1153 (1910).

[14] See *Keeton*, *supra* note 3, at 117-174.

able. The only case in which the insured went through bankruptcy and thus was discharged from the necessity of future payments, as were the Massellos in this case, was *Brown v. Guaranty Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (Dist. Ct. App. 1958). However, in that case there was no evidence that the insured was insolvent *before* the excess judgment was imposed upon him, as were the Massellos. For if the insured's assets exceeded his liabilities exclusive of the excess judgment, then the insured although discharged in bankruptcy, would actually be damaged by the value of his net estate. However, the recovery of that amount by his trustee in bankruptcy would be applied to the payment of his debts. The only way to make the insured whole, *i.e.*, to place him in a position where his net assets are as great after as before payment of the excess judgment, would be to allow him to recover the entire amount of that judgment. In several other cases heavily relied upon by the trustee, the courts were dealing with estates which were solvent before the excess judgments were rendered.[1] In none of the other cases permitting recovery of the amount of the excess judgment without payment was there any evidence that the insured had been discharged from the liability,[2] and in

[1] *Hardy v. Iowa Home Mut. Casualty Co.*, 250 Iowa 341, 93 N. W. 2d 809 (1958); *Lee v. Nationwide Mut. Ins. Co.*, [illegible] 1958 [illegible] The [illegible] the [illegible] the [illegible] the [illegible]

The [illegible] *Farmers Ins. Exchange v. Henderson*, 82 Ariz. [illegible] P. 2d 804 (1957) make it appear that the insured was solvent before the excess judgment.

[2] *Schlegel v. Nationwide Mutual Insurance Co.*, 216 Wis. 650, 256 N. W. 446 (1934); *Herring v. Home Indemnity Co.*, 127 F. Supp. 775 (W. D. Mo. 1955); *Standard Accident Insurance Co. v. Nagy*, 15 Ohio App. 457, 458, 35 N. E. 2d 785 (1941); *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dillingham*, 270 Ala. 119, 116 So. 2d [illegible]

only two cases was there even a hint that the insured was insolvent prior to the excess judgment.[17]

Although no case has found damage in the situation here presented, namely, an insured who was already insolvent before rendition of the excess judgment and has since been discharged in bankruptcy, it is desirable to examine the reasons urged to support liability where the excess judgment rendered the insured insolvent or even where he was already insolvent but did not obtain a bankruptcy discharge, in order to determine whether they are pertinent and therefore persuasive here. The basis most frequently urged for finding damage although there has been no payment is that the insurance company would receive an unjustified windfall if it is released from liability when its insured turns out to be insolvent.[18] We do not agree. The insurer has received premiums only upon the face amount of the policy, and this much it must pay regardless of the insured's financial condition. Although, *arguendo*, the insurance company has committed a tort by refusing to settle in good faith, the gist of tort liability is recompense for harm actually sustained. To argue that the insurer gets an unjustified windfall merely avoids the crucial question whether the insured has actually been harmed. Moreover, if discussion of windfalls were relevant, it should be pointed out that recovery by the trustee would result in a fortuitous recovery for Mrs. Van Sugtendael who, but for the insured's breach of duty to its policyholder, would not have recovered a figure in excess of the policy limit.

Another ground often advanced in support of recovery, that the insurer will be less responsive to its duty to

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[17] *Southern Fire & Cas. Co. v. Norris*, *supra*, note 16; *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dalrymple*, *supra*, note 16.

[18] *Southern Fire & Cas. Co. v. Norris*, *supra*, note 16, 250 S. W. 2d at 791; *Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dalrymple*, *supra*, note 16, 116 So. 2d at 926.

settle if it can avoid liability when its insured is insolvent,[19] is of slender stature, at least as to the situation here. Presumably it is only in a very small percentage of the cases that the insured would be insolvent at the time of settlement negotiations and would later go into bankruptcy, an eventuality the insurer cannot predict. Moreover, this argument obscures the essential question—whether the insured has actually been harmed by the bad faith refusal to settle.

A third theory, advanced as additional support for the idea that damage arises on rendition of the excess judgment, is that the insured might otherwise be forced to pay the judgment at a juncture when his tort action has become barred by the statute of limitations.[20] The argument would hardly be persuasive even if our holding were that damage can never arise merely on rendition of the judgment but only upon its payment—which it is not. For a jurisdiction so holding would necessarily postpone the accrual of the tort claim until the event giving rise to it, *i.e.*, payment.[21]

The final theory frequently relied upon by cases holding the insurer liable although the insured has not paid the excess judgment is that the liability should be treated like medical expenses.[22] Most courts hold that an injured person can recover, as one element of damages in a personal

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[19] See cases cited in footnote 18.

[20] *Brozen* v. *Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69, 76 (Dist. Ct. App. 1958); *Wessing* v. *American Indem. Co.*, *supra*, note 10, at 781.

[21] See *American Mut. Liab. Ins. Co.* v. *Cooper*, 61 F. 2d 446 (5 Cir. 1932), cert. den. 289 U. S. 736 (1933); *Baling* v. *New Amsterdam Cas. Co.*, 175 Okla. 160, 46 P. 2d 916 (1935); Case Note, 72 H. L. R. 568, 569-70 (1959).

[22] *Brozen* v. *Guarantee Ins. Co.*, *supra*, note 20, 319 P. 2d at 76; *Wessing* v. *American Indem. Co.*, *supra*, note 10, at 781.

injury action, the fair value of medical treatment required because of the tort although the injured party has not paid for the treatment.[23] In the great bulk of cases the injured party is liable for the bills at the time of trial and there is no evidence of his inability to pay.[24] In the present case the Massellos have not paid the judgment and will not be required to pay it. Those few cases where the injured party will never have to pay his medical bills because a friend or relative or an insurance company has paid them are not inconsistent with our holding. Although the injured person is not out of pocket the amount of the bills, if a friend or relative pays them, he and his family or friends are. Their generosity has not been directed to the tortfeasor but to their injured friend or relative.[25] Had they given him the money and let him use it to pay his own bills sufficient damage would have been shown. The formal difference that they paid the bills directed should not cause a difference in result. If the bills are paid by an insurance company under an accident or health insurance plan taken out by the injured person, the premiums which he has paid are the price of his protection;[26]

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[23] 25 C. J. S. Damages §47(b).

[24] See *McNair* v. *Manhattan Ry. Co.*, 51 Hun 644, 22 N. Y. St. Rep. 840, 4 N. Y. S. 840 (N. Y. Sup. Ct. 1889), aff'd without opinion, 123 N. Y. 664, 26 N. E. 750 (1890); *Baumgart* v. *Finegood*, 255 App. Div. 826, 7 N. Y. S. 2d 74 (1938); *Reynolds* v. *City of Niagara Falls*, 81 Hun 555, 30 N. Y. St. Rep. 118, 30 N. Y. S. 954 (N. Y. Sup. Ct. 1894); *Hoater* v. *Delaware, L. & W. R.R. Co.*, 90 App. Div. 495, 85 N. Y. S. 524 (1904); *Giovannelli* v. *Fort Orange Constr. Co.*, 148 App. Div. 489, 133 N. Y. S. 92 (1911); *Sanfacon* v. *Briggs*, 278 App. Div. 15, 103 N. Y. S. 2d 1 (1951). Restatement, Torts §924, comment (f).

[25] McCormick on Damages §90 (1935); Restatement, Torts §924, comment (f), 128 A. L. R. 686, 687 (1940).

[26] *Bradburn* v. *Great Western R.R. Co.*, L. R. 10 Exch. 1, 44 L. J. Exch. N. S. 9, 31 L. T. N. S. 464, 23 Week. Rep. 45 (1874) (summarized 18 A. L. R. 678, 683); *Johnson* v. *Kellam*, 162 Va. 757, 175 S. E. 634, 636-37 (1934).

thus he has indirectly paid his own medical expenses. In the present case the judgment was not paid by the Massellos' friends or relatives nor did the Massellos pay premiums on anything above the $10,000 face amount of the policy. We have found only four medical expense cases which reach a result which would support liability by Standard to the trustee in this case. In one case where the medical bills had been discharged in bankruptcy[27] and in three where they were barred by the statute of limitations,[28] courts outside New York permitted the injured party to recover the value of his medical treatment from the tortfeasor.

New York, however, in an early case held that the injured party cannot recover for medical expenses which have not been paid if there is a showing that the injured party is unable to pay them.[29] In none of the later New York cases allowing recovery of medical expenses which the injured party had not yet paid is there evidence that he could not pay them.[30] Therefore, it seems doubtful that New York would not follow the above-mentioned four cases.

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[27] *Sibley v. Nixon*, 196 Mass. 125, 81 N. E. 887 (1907); see Sutherland, Damages §150 (1916). In the case of *Patterson v. Springfield Traction Co.*, 178 Mo. App. 350, 163 S. W. 955, 956 (1914), where the injured party was merely insolvent but not bankrupt, the court allowed recovery.

[28] *Linder on v. Ivan*, 168 Neb. 73, 95 N. W. 2d 44, 54, 55 (1959); *Houston & T. C. R. Co. v. Gould*, 60 Tex. Civ. App. 151, 128 S. W. 166, 170, 71 (1910); *Moeller v. Bolin*, 59 Ind. App. 685, 686 (1897).

[29] *McVey v. Manhattan Ry. Co.*, *supra*, note 24.

[30] See cases cited in footnote 24. Moreover, New York may not even follow the majority rule to the extent of permitting recovery for medical expenses paid by friends and relatives or insurance. See *Drinkwater v. Dinsmore*, 80 N. Y. 390 (1880); McCormick on Damages §87 (1935); 13A N. Y. R. 680, 692 (1940).

Furthermore, the reasoning which supports recovery of medical expenses which the injured person will never pay does not apply to the present case. In personal injury cases the gist of the action is the damage to the plaintiff's person and the medical expenses are merely incidental,[31] whereas in the present case financial damage to the insured constitutes the basis of the cause of action.[32]

This case more closely resembles a suit for indemnity or contribution than one for medical expenses.[33] The New York cases hold that a person secondarily liable for a tort cannot get indemnity from one primarily liable by merely proving that he has suffered an adverse judgment. "The contract of indemnity implied by law, in favor of one who is legally liable for the negligence of another, covers loss or damage, and not mere liability."[34] Thus until the judgment is actually paid, there is no damage and no recovery.[35] Similarly, New York does not permit contribution until one joint tortfeasor has actually paid more than his pro rata share of a judgment against the joint tort-

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[31] *Sibley* v. *Nason*, *supra*, note 27.

[32] *Lee* v. *Nationwide Mut. Ins. Co.*, 184 F. Supp. 634, 646 (D. Md. 1960), reversed, 286 F. 2d 295 (4 Cir. 1961); Case Note, 72 H. L. R. 508, 509 (1959).

[33] See *ibid.*

[34] *Dunn* v. *Uvalde Asphalt Paving Co.*, 175 N. Y. 214, 218, 67 N. E. 439, 440 (1903).

[35] *Milstein* v. *City of Troy*, 272 App. Div. 625, 74 N. Y. S. 2d 892 (1947); *Satta* v. *City of New York*, 272 App. Div. 782, 69 N. Y. S. 2d 653 (1947); *Antonelli* v. *City of Mount Vernon*, 20 Misc. 2d 331, 189 N. Y. S. 2d 52 (Sup. Ct. 1959); *Weiner* v. *Mager & Throne, Inc.*, 167 Misc. 838, 841-42, 3 N. Y. S. 2d 918, 922 (Municipal Ct. 1938); *Cohen* v. *Dugan Bros., Inc.*, 134 Misc. 155, 235 N. Y. S. 118 (1929); *Brozen* v. *Mechanics and Traders' Bank*, 16 App. Div. 207, 44 N. Y. S. 645 (1897); Restatement, Restitution §77, comment (b).

feasors.[36] Consequently, there is no support in the indemnity or contribution cases for a finding of damage here.

Our view is further buttressed by New York's holding in *Cummings* v. *Hackley*.[37] The plaintiff acted as an accommodation indorser of the defendant's note. After default the plaintiff gave the holder of the note a bond to guarantee payment. Since the plaintiff then received a discharge from his liability on the note and bond under the insolvency act, he was not permitted to recover from the maker. It is irrelevant that the plaintiff in *Cummings* would have profited had he been allowed to recover since there was no assurance that he would decide to pay the holder of the note, while in the present case the Massellos would not profit since any recovery would go to their trustee in bankruptcy and be used to pay their debts. The question is not whether the plaintiff will profit from recovery but whether he will be damaged by a denial of recovery. Since the Massellos have been discharged from paying the excess judgment, they, just like the plaintiff in the *Cummings* case, will not suffer any damages if recovery is denied.[38]

Therefore, since the Massellos were insolvent before the excess judgment was rendered, have not paid any part

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[36] New York Civil Procedure Act 211(a); *Balkin* v. *Lezy*, 17 Misc. 2d 50, 184 N. Y. S. 2d 461 (Sup. Ct. 1959); *Mongiovi* v. *Olna Realty Corp.*, 170 Misc. 405, 10 N. Y. S. 2d 528 (City Court of N. Y. 1939); *Miller* v. *Green*, 176 Misc. 803, 26 N. Y. S. 2d 54 (Sup. Ct. 1941).

[37] 8 Johns. 202 (N. Y. Sup. Ct. of Judicature 1811).

[38] The cases of *Decker* v. *Mathews*, 12 N. Y. 313 (1855), and *Metropolitan Elevated Ry.* v. *Kneeland*, 120 N. Y. 140, 24 N. E. 381 (1890), cited by the plaintiff, are not inconsistent with *Cummings*. Since in the former two cases there was no evidence that the plaintiff could not pay the notes, the court acted properly in permitting recovery although they had not yet been paid.

of it, and have been discharged from any future obligation to pay it, their trustee has not shown any right to recover as the existence of the $89,000 judgment has not constituted any actual damage to them.

Even though there is no pecuniary loss to the Massellos, it may be argued that they have suffered injury to reputation and credit.[39] Although it is not clear whether such injuries are within the range of damages to be allowed for a bad faith refusal to settle,[40] the trustee, in his brief, argues that the excess judgment forced them into bankruptcy and that unless it is paid in full they will be unable to go back into business and establish their credit. We do not agree. The record makes it clear that nearly a year before the entry of Mrs. Van Suetendael's judgment the Massellos' two businesses were sold by the City Marshal of Yonkers at the request of creditors, that after the sale there were and still are unpaid debts owing by the Massellos totaling in excess of $12,000, that the Massellos had been employed as truck drivers immediately prior to their petition in bankruptcy, and that they had total assets of $200. The trustee introduced no testimony of any specific injury to the Massellos' credit or reputation. On such a

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[39] The only allegation as to damages in the complaint relates to the $105,000 judgment; there is no mention of injury to reputation and credit.

[40] Compare *Farmers' Insurance Exchange* v. *Henderson*, 82 Ariz. 335, 313 P. 2d 404, 408-09 (1957) (denying recovery for injury to reputation in an action against an insurer for bad faith refusal to settle), and *Lee* v. *Nationwide Mut. Ins. Co.*, 184 F. Supp. 44, 46-47 (D. Md. 1960), reversed, 286 F. 2d 295 (4 Cir. 1961) (same), with *Keeton*, *supra*, note 5, at 1181 n. 110 (*contra*). New York does not permit recovery for injury to reputation when an employee is discharged in breach of his contract. *Sinclair* v. *Polytype Corp.*, 257 App. Div. 525, 529, 261 N. Y. S. 900, 904-05 (1933), but does allow recovery for injury to reputation and credit in an action for malicious prosecution. E.g. *Sheldon* v. *Carpenter*, 4 N. Y. 579 (1851); *Limitsky* v. *Gorman*, 146 N. Y. S. 515, 517-18 (City Ct. of N. Y. 1914).

record it is clear that there is no proof that the Massellos' inability to pay the Van Suetendael judgment resulted in any damage to them.

One possible theory of damage remains. Without Mrs. Van Suetendael's excess judgment, the Massellos' creditors other than Mrs. Van Suetendael would have received the entire bankruptcy estate. Because she proved her claims in bankruptcy the other creditors will receive only about 12% of the Massellos' estate. Therefore, Standard's bad faith has damaged the other creditors by the amount of the decrease in assets which they will receive. It is not at all clear that under New York law Standard has any obligation to its insured's creditors upon which to found a liability to them for failure to settle in good faith.[1] Nor if New York created such a duty does there appear to be any provision in the bankruptcy act that empowers a trustee in bankruptcy to sue on such a cause of action which belongs to his bankrupt's creditors. However, because of the facts of this case, we need not even reach these questions. Since the Massellos' assets total only $290, we cannot suppose that after payment of the costs of administration, there would be anything remaining for distribution to the other creditors. Therefore, Mrs. Van Suetendael's claim will not reduce the dividends of the other creditors and they have not been damaged by Standard's bad faith.

As there has been no proof of damage, the judgment of the district court is reversed and the complaint is dismissed.

[1] See Bryant v. American Indemnity Co., 137 F. Supp. 778, 782, 83 (W. D. Mo. 1955).

Dissenting Opinion

SMITH, *Circuit Judge* (dissenting):

I respectfully dissent.

We are in the difficult position of attempting to predict how far the New York courts would go in setting the limits of recovery on a type of claim which they have indicated will be held good, but which they have not as yet actually enforced. If, as I feel, the New York courts would enforce the duty of an insurer in good faith to live up to his contract in the settlement of claims against the insured, I would expect them to do so with a view to the actualities of personal injury and death losses in our present society, and the interest of the injured in the proper functioning of our system of liability insurance of those from whose faults injuries may arise. I would not expect them to require that the insured establish payment or ability to make payment by him of a judgment against him in order to show a compensable loss in the situation here disclosed. The insurer has for a price agreed to insure him against liability to injured plaintiffs. This includes, as New York has stated, the duty to use good faith toward the insured in settlement negotiations. The finding of bad faith in the case at bar is amply supported by the record here.

New York has demonstrated an interest in preventing insurance companies from avoiding payment to injured parties to whom the insured is liable solely because of the insolvency of the insured. New York Insurance Law § 167 (1)(a) and (b).[1] It is true that the statute provision is

[1] 1. No policy or contract insuring against liability for injury to person, except as stated in subsection three, or against liability for injury to or destruction of property shall be issued or delivered in this state unless it contains in substance the following provisions or provisions which are equally or more favorable to the insured and to

keyed to the policy limits. When this legislation was originally enacted in 1917, however, the problem of bad faith refusal to settle had not become the live issue it is today. I can see no sound reason for allowing the insurer to invoke the defense to an action for breach of its duty to use good faith in settlement when it is denied the defense for actions for breach of the duty to pay within the policy limits. If the insured had remained solvent through the years between the injury in 1952 and the final bad faith refusal to settle and judgment for an amount in excess of the policy limits in 1957, the majority's requirement for showing of damage presumably could have been met. But suppose his net worth was 25 or 50% of the amount of the judgment? I am not clear whether actual payment would be required by the majority, or solely ability to pay, to establish damage. If we grant that the insured may have indemnity to some degree arising out of the policy because of bad faith refusal to settle within the stated limits, the "coverage of the policy or contract" within the meaning of the statute may well in such a case be held to extend to

judgment creditors so that no such provision relates to judgment creditors.

[1] A provision that the insolvency or bankruptcy of the insured, or the insolvency of his estate, shall not release the insurer from the payment of damages for injuries sustained or loss occasioned during the life of and within the coverage of such policy or contract.

[2] A provision that in case judgment against the insured or his personal representative in an action brought to recover damages for injury sustained or loss or damage occasioned during the life of the policy or contract shall remain unsatisfied for the period of thirty days from the serving of notice of entry of judgment upon the attorney for the insured, or upon the insured if he has no attorney, then an action may, except during the pendency of a stay of execution against the insured on such judgment, be maintained against the insurer under the terms of the policy or contract for the amount of such judgment not exceeding the amount of the applicable limit of coverage under such policy or contract.

the full amount of the judgment. In this situation the courts should not require an insured to show that he could meet the full amount of a judgment to establish damage from the insurer's tort. Here the insurer's contract, entered into for a consideration not only binds it to pay the face amount of the policy but also to use good faith in settlement efforts. If we say that there can be no damage to an insolvent from a tortious breach of the latter duty we not only depart from the spirit of New York's concern for the injured victim of an insured driver, but leave the insured himself with an illusory protection. The Massellos were in business during a good part of the period between the making of the insurance contract and its breach by defendant. Although there is evidence that they became insolvent by August 1956, the insurer had already refused to settle within the policy limits in April 1956. We do not know whether the pendency of the action affected their credit. The majority assumes that they were doomed to bankruptcy in any event. This is not certain. Bankruptcy followed only after entry of the judgment. If this judgment had not been entered against them bankruptcy might not have been necessary and its effect on their future business prospects might have been avoided. The damage may not be precisely measurable, but that circumstance should not allow the tortfeasor to go free. The insurer deliberately exposed its insured to the danger. It should not be heard to say that the great increase in the insured's debts caused by its action caused no damage because he might have had to go into bankruptcy in any event. Moreover, this view of the nature of damage from the breach of duty opens the distinct probability that the shaky financial condition of an insured will be used as an improper device for driving down settlements in serious injury and death cases below policy limits on threats of prolonged litigation at no risk to the insurer.

I would affirm the judgment.

Statute Involved

BANKRUPTCY ACT § 70(a)

(11 U. S. C. § 110(a))

"Title to property

(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * * (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: Provided, That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process: And provided further, That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings; otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or from the unlawful taking or detention of or injury to his property; * * *"